April 14, 2010

Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, D.C. 20551

Docket Number: R-1384
Submitted Via Email to:

Dear Ms. Johnson:

Thank you for the opportunity to comment on the proposed Truth in Lending rule implementing provisions of the Credit Card Accountability Responsibility and Disclosure Act (CARD Act) effective August 22, 2010.

The Credit Union Association of Oregon (CUAO) is a nonprofit, professional trade association representing Oregon's state, community, and federally-chartered credit unions. Since 1936, CUAO has been at the forefront of credit union issues at the state, regional, and national level; and provides a voice for Oregon's 1.4 million credit union members on issues impacting credit unions at a local level.

Oregon's credit unions support the overall efforts of Congress and the Federal Reserve Board to protect consumers from unfair credit card practices. We recognize the Board has made positive strides in balancing the statutory language and intent of Congress with effectuating the rules for implementation.

The Board proposes to amend Regulation Z, which implements the Truth in Lending Act and the staff commentary to the regulation in order to implement provisions of the Credit Card Accountability Responsibility and Disclosure Act of 2009 that go into effect on August 22, 2010.

The proposal affects credit card accounts under an open end consumer credit plan.

Specifically, the proposal addresses two issues:

1. New TILA Section 149 - Requires that penalty fees imposed by card issuers be reasonable and proportional to the violation of the account terms.
    a. Fees based on costs.
    b. Fees based on deterrence.
2. New TILA Section 148 - Requires credit card issuers to reevaluate at least every six months annual percentage rates increased on or after January 1, 2009.

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The following comments will focus on several key issues in the proposal:

- Fees:
  - Fees and the "reasonable and proportional" theory;
  - The Safe Harbor alternative;
  - Limitations on fees;
- Reevaluation of rate increases;
- Changes affecting disclosures.

Fees

The FRB proposes that any penalty fee or charge that a card issuer may impose in connection with any omission or violation of, the cardholder agreement, including any late payment fee, over-the-limit fee, or any other penalty fee or charge, shall be reasonable and proportional to such omission or violation.

The proposal permits issuers to use penalty fees to pass on the costs incurred as a result of violations. To base penalty fees on costs is very appropriate and a fair way of assessing a charge to offset the costs associated. However, there are multiple issues with respect to our "seeming" ability to base fees on costs.

First, the proposed rule states that, although higher rates of loss may be associated with particular violations, those losses and related costs (such as the cost of holding reserves against losses) are to be excluded from the cost analysis. Loss reserves are resources set aside to offset various types of financial loss or obligation. Loss reserves are a large part of the costs associated with lending. There is much analysis that goes into projecting an adequate amount of loss reserves. The analysis must include historical and current loss experience. It is exactly the behaviors noted, late payments, transactions taking the account over-the-limit, and payments being returned for non-payment that are frequently indicators of a trend toward increasing losses. To fully calculate the costs associated with such behaviors, it is only reasonable to include the costs of holding reserves to insure against credit card loss, which is where some of these accounts will eventually end up. The cost analysis should include calculating all the costs, including the costs associated with holding reserves against losses.

It must also be noted that in an effort to protect consumers from excessive fees and charges, the proposal ultimately spreads the costs and fees among all credit card holders, including the majority who do responsibly manage their credit card accounts. To limit fees to an amount that does not exceed the dollar amount associated with the violation will force fees elsewhere to cover program costs or will force changes to the program to control behaviors, such as not allowing an account to go over the limit. The proposal uses the example where an account is $5.00 over the limit, to indicate that the fee for that violation can't exceed $5.00. How exactly does that indicate the actual cost associated with that behavior? We encourage the board to allow the consideration of all the costs associated to determine a reasonable fee.

Secondly, the proposal would require the card issuer to re-evaluate their costs annually. An annual review of the actual costs and an adjustment to the cardholder based on the findings may result in communications to cardholders on a more frequent basis than would be beneficial. It would serve to confuse consumers and ultimately increase the costs even further. A decision to perform a cost review should be left to the issuer depending upon portfolio, market and experience factors.

Deterrence of violations: as an alternative to basing penalty fees on costs, the proposed rule permits a card issuer to charge a penalty fee for a particular type of violation if it has determined that the amount of the fee is reasonably necessary to deter that type of violation. This would require issuers that base their penalty fees on deterrence to use an empirically derived, demonstrably and statistically sound model that reasonably estimates the effect of the amount of the fee on the frequency of violations.

In order to support a determination that the dollar amount of a fee is reasonably necessary to deter a particular type of violation, a model must reasonably estimate that, independent of other variables, the imposition of a lower fee amount would result in a substantial increase in the frequency of that type of violation. To my knowledge such a model does not exist. Does this really provide a viable alternative?

The proposal further allows that in an effort to assess how much of a fee would provide a true deterrent, an issuer can charge a different fee to different groups to gauge how much to charge to deter certain behaviors. This method just spells trouble in a multitude of ways, including everything from possible disparate treatment claims, fee disclosure irregularities, consumer confusion and downright unfair treatment, which is why we are here in the first place. Such a practice should not be allowed or encouraged and is not a viable alternative.

The safe harbor would require the FRB and joint agencies provide an amount for any penalty fee or charge that is presumed to be reasonable and proportional to the omission or violation to which the fee or charge relates.

The Board would adopt a safe harbor amount for penalty fees that the Board believes would be generally sufficient to deter violations.

An issuer can adopt the safe harbor to ensure compliance. The proposal does not indicate what methodology the FRB and the agencies would utilize to make that determination. The Board noted in the proposal that many credit unions charge late-payment and over-the-limit fees of $20 on average. Similarly, the *Pew Credit Card Report* found that the median late-payment and over-the-limit fees charged by the twelve largest credit union card issuers were $20.70. This is opposed to the median $39.00 fee PEW found the 12 largest bank card issuers charged. Clearly it is not credit unions that caused the excessive fees affecting consumers and resulting in congressional action. We advise that any safe harbor allow for a reasonable penalty fee and deterrent fee to be charged per violation and does not limit that fee to the amount of the violation or to just one violation. Such action would appropriately place the fee on those whose behavior warrants such fees and not spread broad ramifications to all consumers.

Lastly, as it relates to fees, only one penalty fee to deter behavior which violates the card agreement would be allowed to be charged even if multiple violations occur within the same transaction. If a cardholder makes a late payment, and that payment is returned for non-payment which at the same time leaves the account over the limit, only one fee may be charged, and only as it relates to the violation. Which violation takes precedence to determine the fee? How are fees to deter violations a deterrent if not all violations are penalized?

Reevaluation of rate increases

The Board recognizes that an issuer's underwriting standards may change over time, accordingly, the proposed rule would permit a card issuer to review either the same factors on which the rate increase was originally based, or to review the factors that the card issuer currently considers when determining the annual percentage rates applicable to its credit card accounts. We support the latitude afforded here.

The proposal would require creditors to disclose the reasons for an annual percentage rate increase applicable to a credit card under an open-end consumer credit plan in the notice required to be provided 45 days in advance of that increase.

The Board is proposing that a card issuer must disclose no more than four principal reasons for the rate increase for a credit card account under an open-end (not home-secured) credit plan, listed in their order of importance, in order to implement the notice requirements of new TILA Section 148. There is no other requirement in Regulation Z or other regulation which dictates the maximum or minimum number of reasons for denial of or limitations placed on credit, such as under Adverse Action requirements of Fair Credit Reporting Act. The FRB makes no valid argument on why the limit to just four reasons for an increase in rates. The determination and notice should address all applicable reasons for the increase and not be limited in number.

Changes affecting disclosures

Currently, any fee or percentage amounts for late payment, returned payment, and over-the-limit fees must be disclosed in bold text. However bold text shall not be used for any maximum limits on fee amounts unless the fee varies by state.

Under this proposal, disclosure of a maximum limit (or "up to" amount) will generally be necessary to accurately describe penalty fees that are consistent with the new restrictions.

The Board is proposing to require the use of bold text when disclosing ANY maximum limits on fees required to be disclosed, including maximum limits for cash advance and balance transfer fees. The benefit of such disclosures "in bold" is not clear, especially if a multitude of fees will be required to in bold. Rather significant fees such as any fee or percentage amounts for late payment, returned payment, and over-the-limit fees, whether minimum or maximum, should be the only fees required to be disclosed in bold text.

Closing comments

Credit is a privilege. Some would appear to have forgotten that concept. Responsible consumer financial behavior is rewarded with credit granted by lenders who take risks with every credit decision made in the course of business from the original request, to each subsequent advance. Credit union overall responsible lending practices, their focus on member relationships, and financial education has allowed credit unions to manage risk in a way that is beneficial to both the credit union and their member. Bad financial behavior is not encouraged or rewarded as the costs associated ultimately affects all members, the majority of whom, handle their financial obligations in a responsible manner. The irony of the use of the term "responsible" here, throughout this commentary and within the text of the *Credit Card Accountability Responsibility and Disclosure Act of 2009*, should not be lost on the reader.

Thank you for affording us the opportunity to comment, and I sincerely appreciate your consideration.

If you have any questions or would like further information, please feel free to contact me at the CUAO office, 800-688-6098 ext 214.

Respectfully Submitted,

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